



Solving Complex Business Problems

Federal Strategic Sourcing Initiative

Office Supplies Commodity Team

Market Analysis

FINAL

Washington, DC

December 2006



U.S. General Services Administration

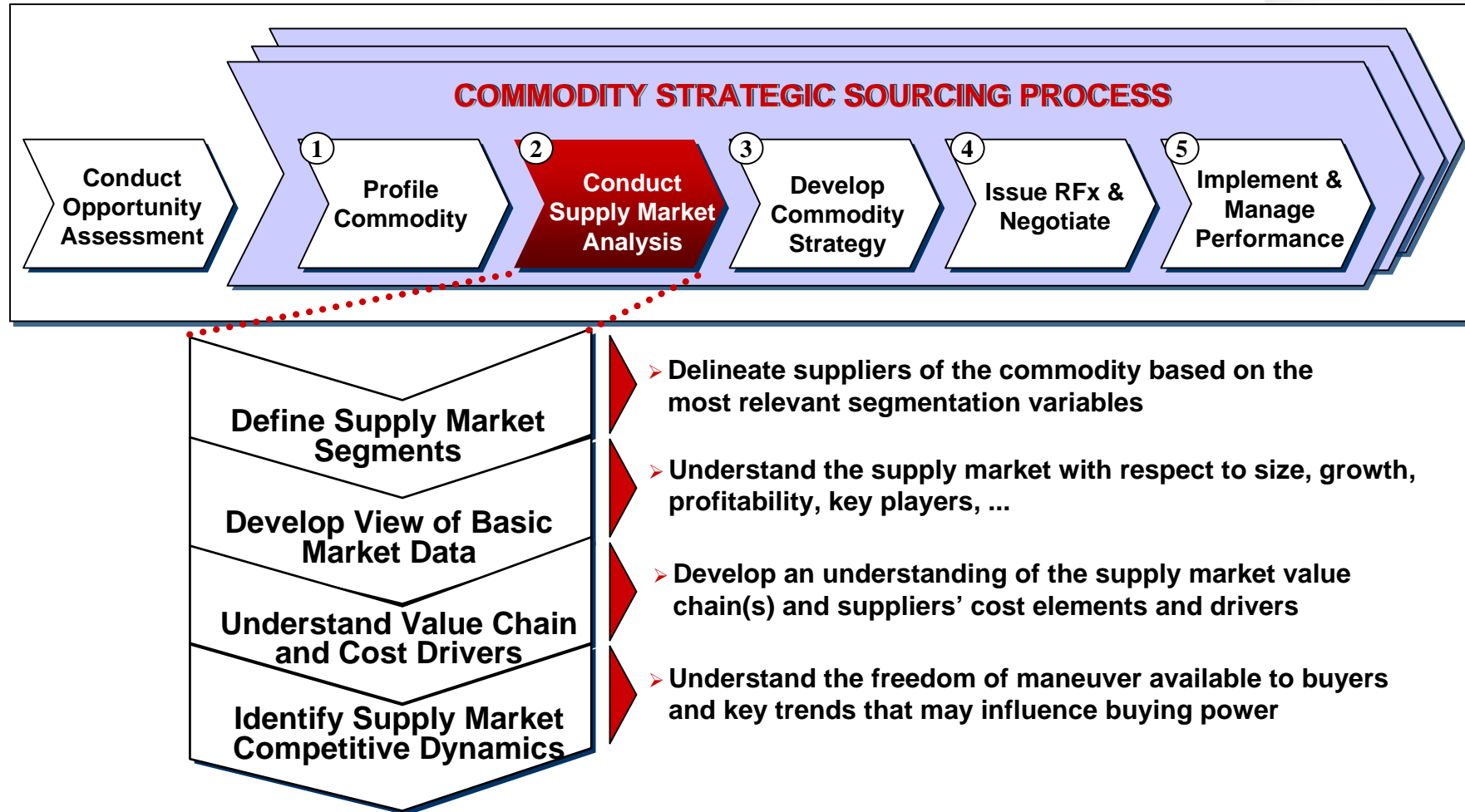
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- **Implications to Sourcing Strategy**

This report focuses on understanding how market dynamics influence strategic sourcing opportunities for the Office Supplies commodity

OVERALL STRATEGIC SOURCING PROCESS



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The supply market provides several insights that will be used in developing the overall office supplies commodity strategy



KEY OPPORTUNITY AREAS

The supply market analysis suggest the following as key (supply market-based) sourcing opportunity areas for the Office Supplies commodity:

- **Competition among suppliers** – ensure a strong competitive context among suppliers in the RFQ process as this is still the primary means of competition.
- **Volume consolidation (to a degree)** – larger accounts are certainly more attractive to suppliers – volume should be leveraged when possible, however, the suppliers have limited ability to offer ever increasing discounts based on increasing spend volume levels.
- **Well structured negotiations strategy** – ensuring a strong competitive context should be carried forward through negotiations preparation and execution as pricing varies widely within this market – the “best” prices can only be obtained through maintaining a strong competitive context throughout the supply market engagement period

EXECUTIVE SUMMARY HIGHLIGHTS

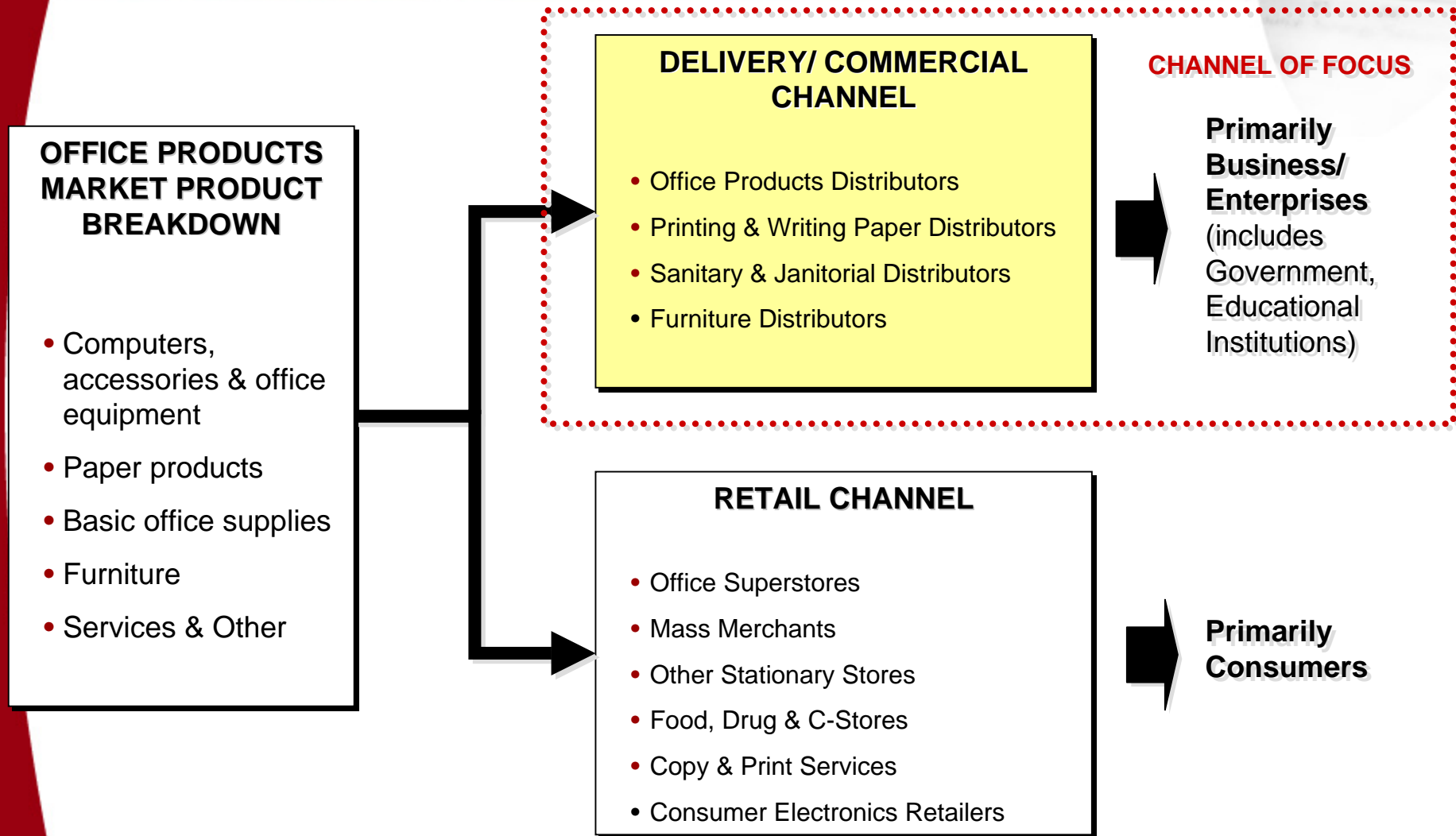
1. **Large NA Office Products market exhibiting slow growth** – The overall NA office products market is \$323M growing at a slow but steady rate of 3% per year.
2. **Two major channels to reach customers** – The two major sales channels are the retail channel (e.g. office products super stores, mass merchants, etc ..) and the deliver channel (e.g. contract sales to enterprises, government, educational institutions, etc ...)
3. **The market is fragmented** – The top 4 suppliers in the delivery channel constitute only 16% market share collectively.
4. **Large number of small office products resellers/ dealers** – There are thousands of resellers/dealers in the delivery channel, reflecting the relatively low entry barriers in this supply market.
5. **Bases of competition include cost/price, product breadth, and attempted brand differentiation** – Price is still a major competitive factor among the major suppliers, though recently brand differentiation, and increasing product breadth (e.g. through private label) have also been utilized by suppliers in competing for customers.
6. **Competitive intensity is very high among suppliers** – Overall, competitive intensity is very high in the delivery channel for attracting new customers and retaining existing ones, often resulting in significant price competition for new business.

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The office products market consists of two primary channels that sell a variety of products and services (including basic office supplies)



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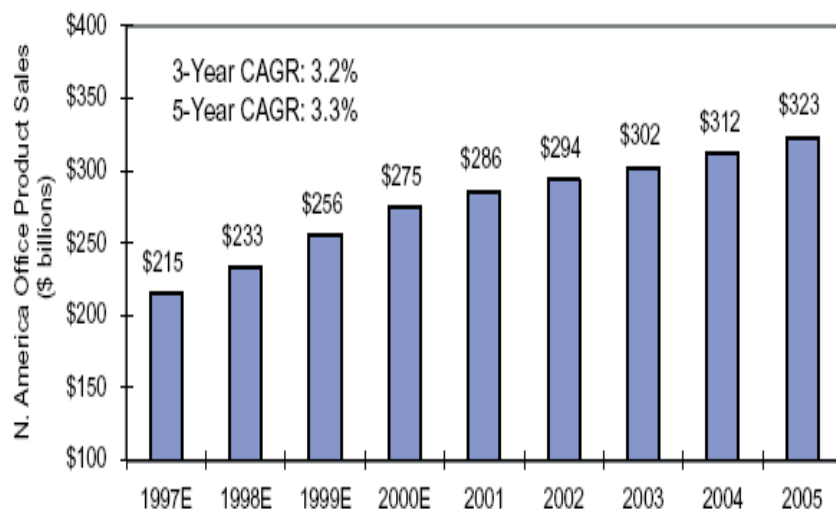
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The NA office products market is a \$323B market with slow but steady growth

The overall NA office products market size was \$323B in 2005, with steady growth in recent years of about 3% per year

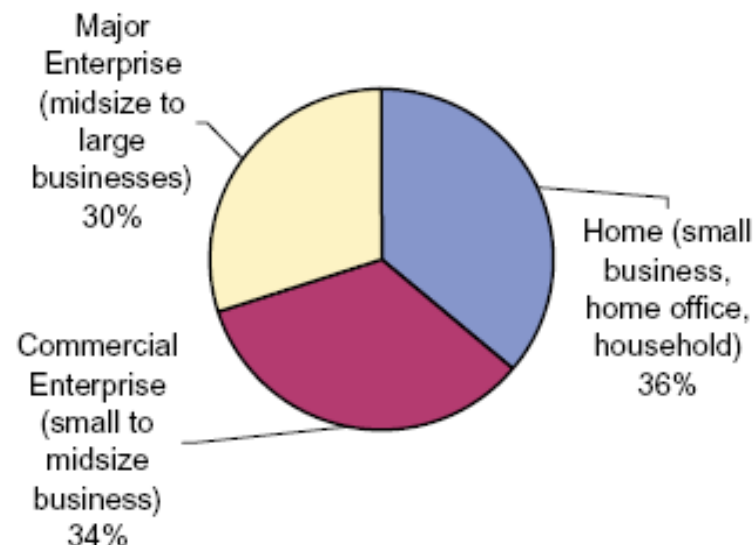
**NA OFFICE PRODUCTS MARKET SALES
1997-2005 (\$B)**



Source: SHOPA

Enterprise customers, including government, and educational institutions, account for approximately 64% of the market

**2005 NA OFFICE PRODUCTS SALES BY MAJOR
CUSTOMER SEGMENT
(TOTAL = \$323B)**



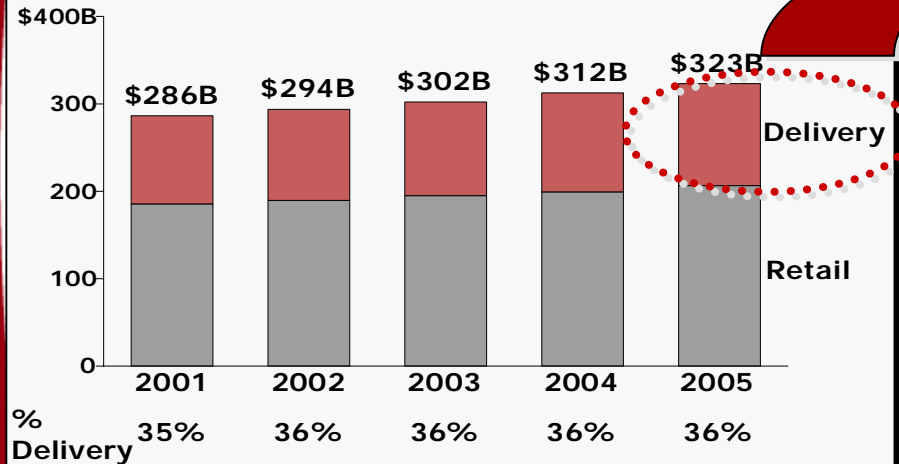
Source: SHOPA

Opportunity for substantial growth (beyond 3% per year) for individual suppliers requires taking share from competitors

The delivery segment is approximately 36% of the NA office products market and is dominated by sales of paper and basic office supplies

The delivery channel has been holding steady at just over one-third of total NA office products sales over the past five years

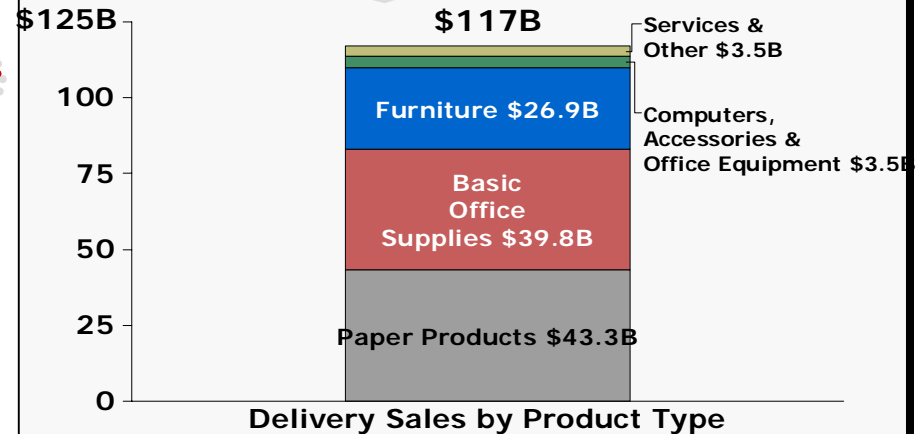
**NA OFFICE PRODUCTS SALES BY CHANNEL
1997-2005 (\$B)**



Source: SHOPA

Paper products and basic office supplies constitute approximately 71% of delivery channel sales

**2005 NA OFFICE PRODUCTS DELIVERY CHANNEL
SALES BY PRODUCT CATEGORY**

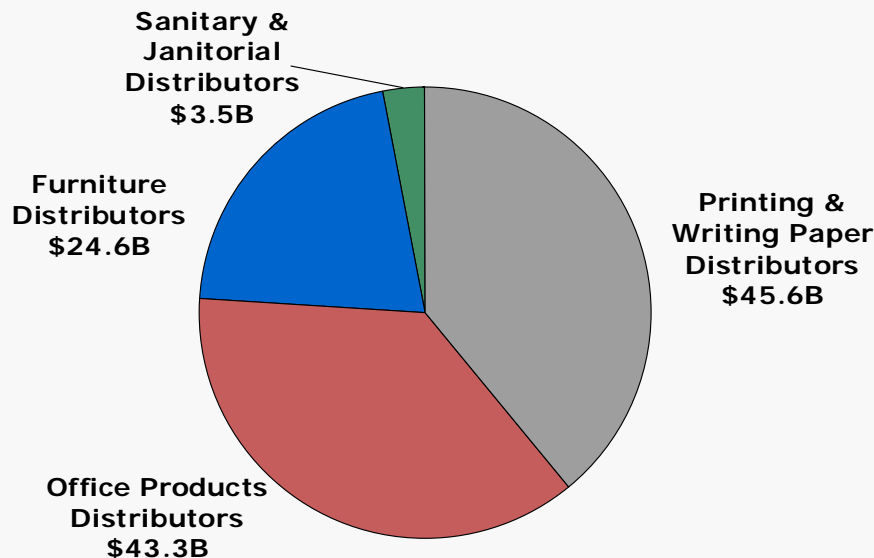


Source: SHOPA

The delivery segment of the office products market is highly fragmented, with the top 4 well-known suppliers having only 16% collective share

There are 5 major business types that sell office products in the delivery channel

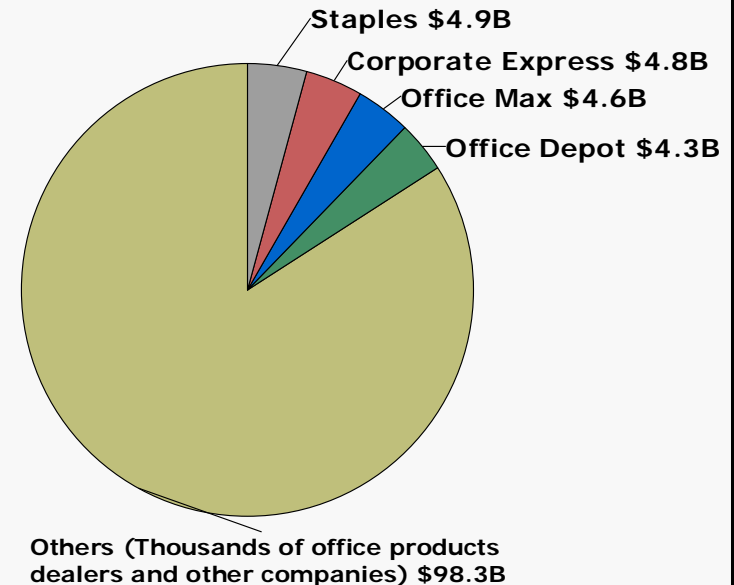
**2005 DELIVERY CHANNEL SALES
BY BUSINESS TYPE
(TOTAL = \$117B)**



Source: SHOPA; Censeo Analysis

The large, well-known suppliers hold just 16% market share of the delivery channel in aggregate

**2005 DELIVERY CHANNEL SALES
TOP 4 SUPPLIERS
(TOTAL = \$117B)**



Source: SHOPA; Censeo Analysis

The fragmented delivery segment with top suppliers having small total share implies that smaller companies have significant presence in this supply market, but also may be at risk of share loss by the larger suppliers' growth aspirations

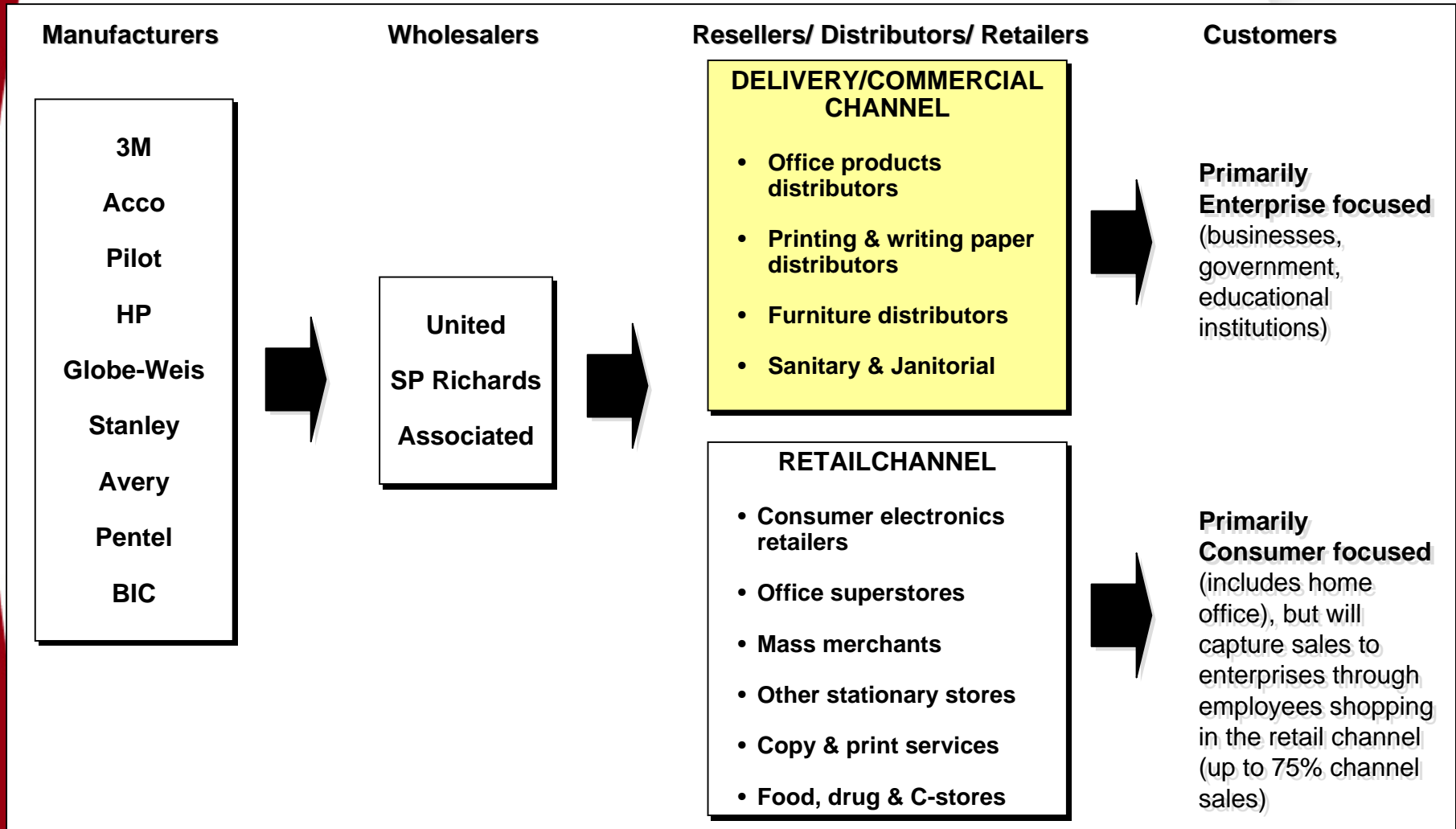
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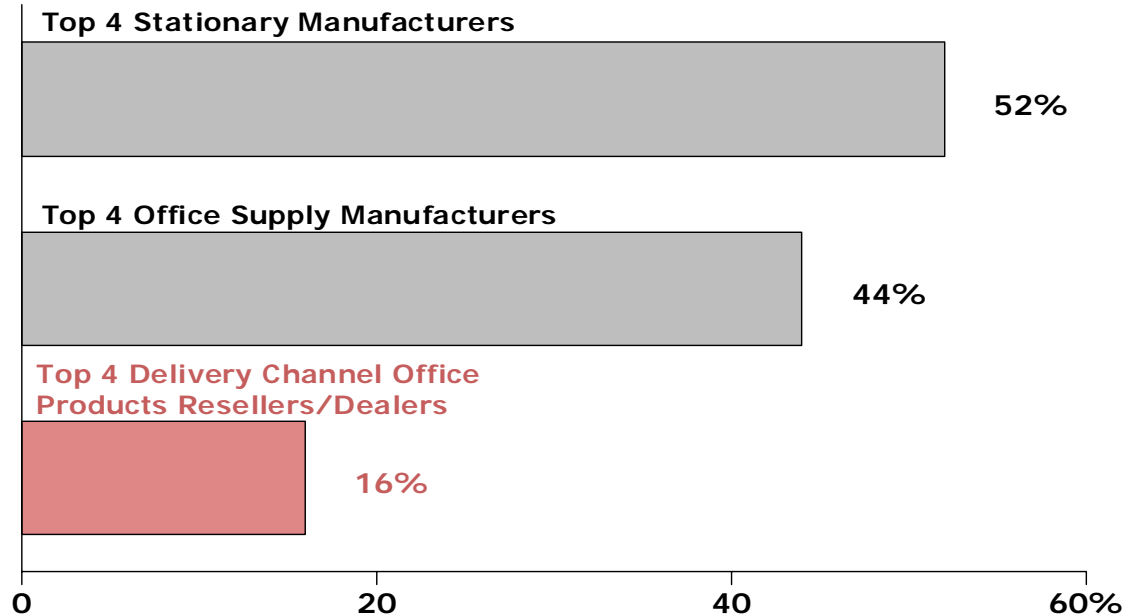
The delivery channel targets enterprises, government, and educational institutions

NA OFFICE PRODUCTS MARKET HIGH LEVEL VALUE CHAIN



The delivery channel is far more fragmented than the manufacturer segment of the value chain, reflecting the ease of entry by smaller players

**VALUE CHAIN FRAGMENTATION
TOP 4 SALES BY VALUE CHAIN POSITION
(% OF TOTAL SALES)**



Source: William Blair & Company, April 2006

KEY POINTS

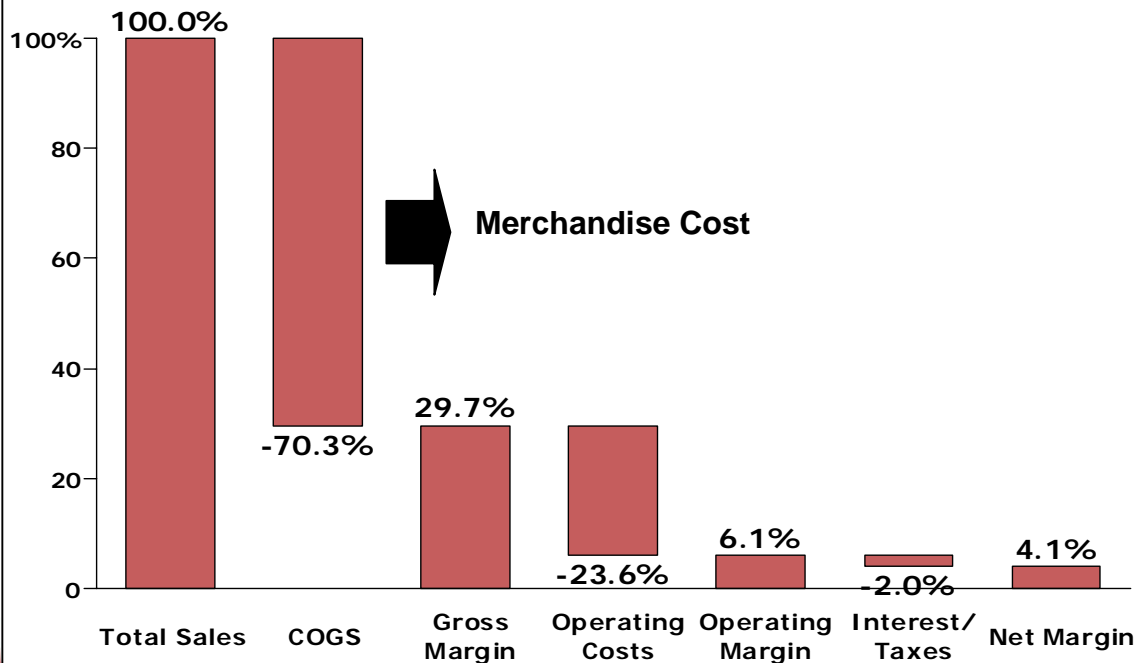
- The stationary and office supply manufacturer segments of the value chain are far more concentrated (far less fragmented) than the Office Products Delivery Channel, due to:
 - The sophistication of the assets required for manufacturing operations
 - The established relationships with the downstream value chain
- Entry barriers are relatively lower for the resellers/ dealers in the Delivery channel as compared to manufacturers



Low entry barriers have enabled thousands of small to mid-sized business to enter and play in the delivery segment

Margins in the office products retail/delivery market overall are thin, with cost structure dominated by COGS (merchandise costs)

**COST STRUCTURE BREAKDOWN
AVERAGE-STAPLES/OFFICE DEPOT
2005 DATA (% OF SALES)**



Source: William Blair & Company, April 2006; Morgan Stanley, "Office Products", August 2006

KEY POINTS

- Cost structures for Staples/Office Depot combined show that the major players exhibit high variable costs – COGS is 70% of sales
- "Operating Costs" includes the cost of marketing/advertising, internal operations, etc ...
- Larger players likely have an advantage in negotiating with manufacturers of office products

The high variable cost structure implies that the effect of leveraging a very large volume of spend may not be that significant

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The major players in the delivery channel seek to compete on cost, product breadth, and brand differentiation



BASES OF COMPETITION

SELECT EXAMPLES/ SUPPORTING POINTS

1

PRICE BASED COMPETITION – Despite other efforts to improve customer retention and attract new accounts, price based competition remains fierce in the delivery channel



- Price is still the primary means of competition among the major players in the delivery channel.
- Price points vary significantly between the retail channel and the delivery channel, with delivery channel prices themselves exhibiting significant variation

2

LEVERAGE SCALE & INCREASE SCOPE – Enables the larger players to compete among themselves as well as take share from smaller competitors through improving their cost position and increasing category depth



- The top office product distributors are growing sales by expanding into categories not traditionally served by office product distributors, including cleaning and break-room supplies, mail and ship, and high-margin copy and print services.

3

BRAND DIFFERENTIATION – Provides a meaningful competitive advantage relative to competitors offering nearly identical products at similar price points



- As an example, Staples has launched a number of programs and initiatives in both the retail and delivery business to improve the customer experience and build the brand including the “that was easy” marketing campaign, the easy service customer service model, and the easy rebate program.

4

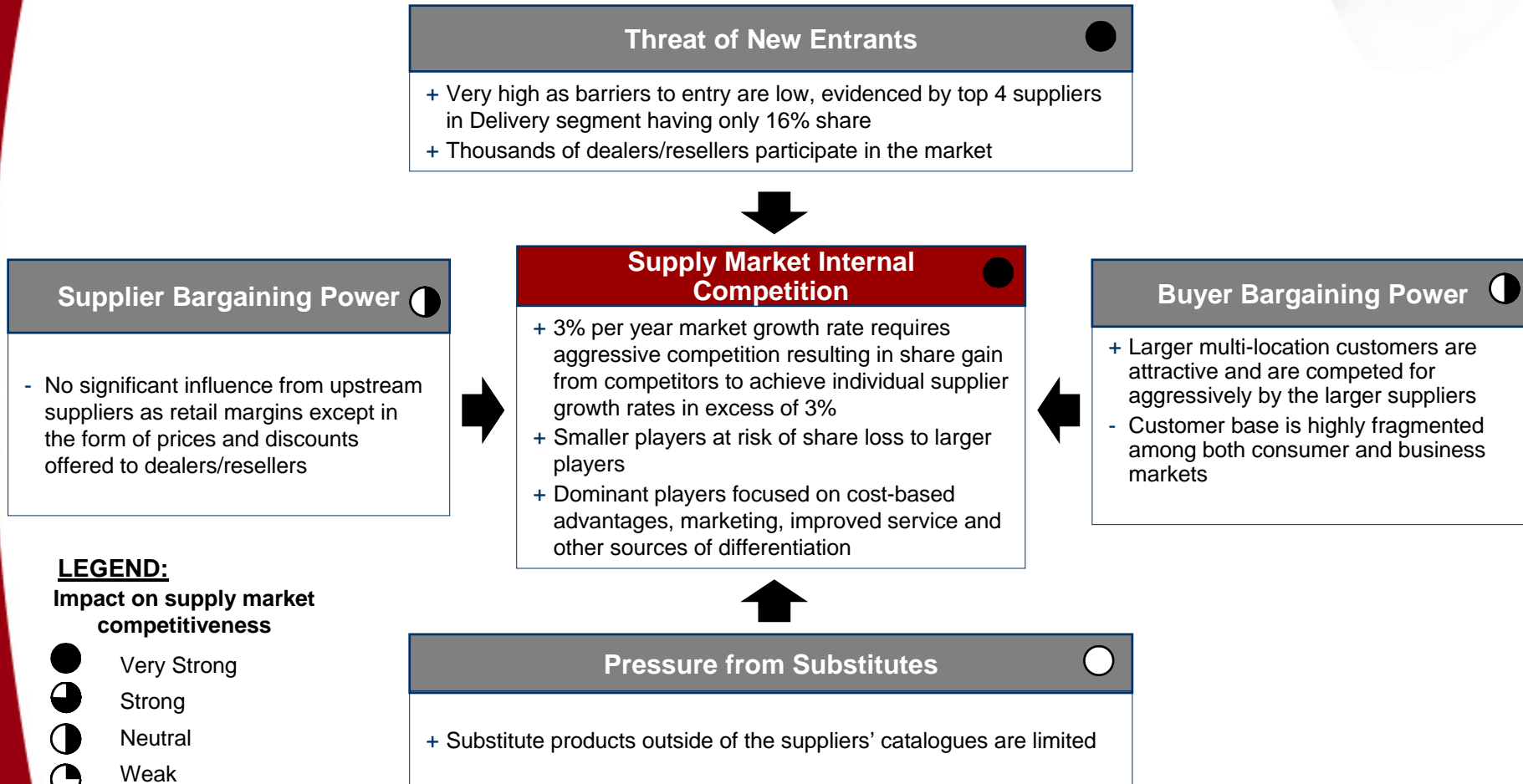
FOCUSED MARKETING EFFORTS – Targets acquisition of new customers and enhances existing customer relationships



- Office Depot has refined its catalog circulation and expanded the use of an outbound telephone account management program focused on small businesses.
- In addition, Office Depot is growing the number of representatives in its contract sales force to increase sales with large customers.

Supply market competitiveness is high within the NA office products market and is reinforced by relatively easy market entry

FIVE FORCES ANALYSIS SUMMARY



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To Be Completed After Receipt of Completed RFQs



**To Be Completed After RFQs are Returned from Suppliers –
Information Collected from Small Business RFQ Responses will
be summarized**

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The office products market exhibits fierce competition among major players which benefits buyers who foster the competitive context

KEY FINDINGS & IMPLICATIONS TO SOURCING STRATEGY

KEY FINDINGS		SUPPORTING DETAIL	IMPLICATIONS TO SOURCING STRATEGY
1	Office products market experiencing slow but steady growth	<ul style="list-style-type: none"> ▪ Slow industry growth – The overall NA market is growing at 3% per year ▪ Significant growth requires taking share – Individual supplier growth in excess of 3% per year must come from share gains against competitors ▪ Larger suppliers compete aggressively – Among themselves and in targeting share gains from smaller rivals 	Embrace the competitive context – The industry is highly competitive with the major players setting the tone for improved cost structures and broader offerings, such as print services and private label
2	Major players aggressively targeting new customers	<ul style="list-style-type: none"> ▪ New marketing programs – major players are enhancing their marketing/branding efforts to target new customers and improve retention of existing ones ▪ Offerings are largely undifferentiated – major players all have similar product offerings with similar service levels 	Price-based competition still key for suppliers – Despite the focus on marketing, price-based competition is still the primary means of winning new accounts and defending existing ones
3	Cost structures dominated by “Cost of Goods Sold”	<ul style="list-style-type: none"> ▪ Cost of Goods Sold (COGS) 70% of sales – Staples/Office Depot average COGS are 70% of sales, reflecting the typical cost structure of a retail/distribution business 	Large spend scale benefits may be limited – Given suppliers’ high variable cost, while large accounts are certainly attractive, increasing levels of spend may not correlate to ever decreasing prices



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